Facebook, Inc.

Bearish Outlook / 2020 Q2 Earnings Report

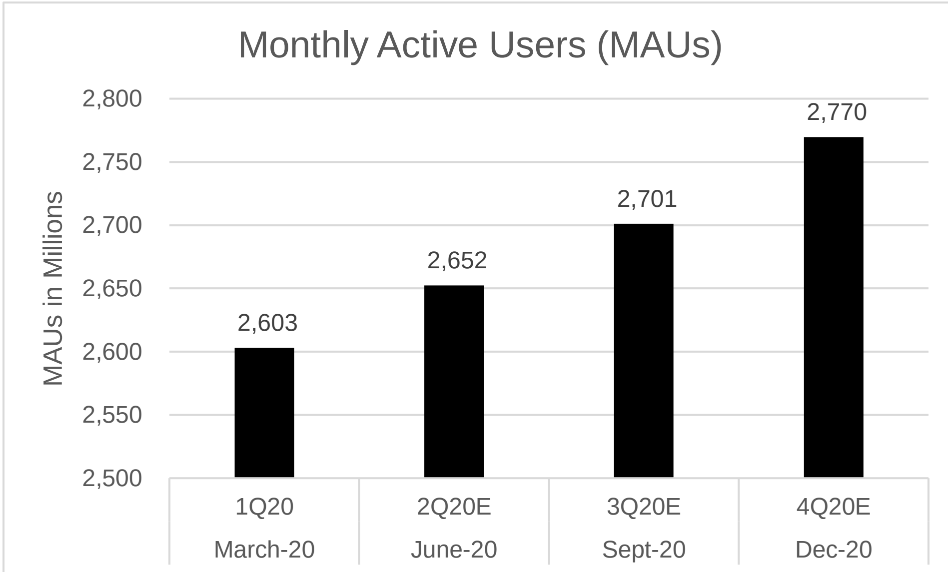
- **Facebook 2020 Q1 Earnings Report:** Facebook reported strong growth in its earnings report for Q1 of 2020. The company saw a substantial increase in both their Daily Active Users (DAUs) and their Monthly Active Users (MAUs) on the main Facebook site as well as Family sites, which include Instagram, WhatsApp, etc. These increases ranged from 10% to 12% year-over-year. Also, Facebook continues to show that they have capital available for current and possible future uses. Cash, cash equivalents, and marketable securities totaled 60.29 billion as of the end of Q1, March 31st, 2020.

- **Company Guidance**: Facebook has stuck with its guidance and financial outlook for the near future. Although there has not been any specific revenue guidance, management has disclosed other values related to the company's future performance and expectations. The main area of guidance outlined in the earnings conference call was that the total expenses for 2020 are expected to be between $52-56 billion, down from the firm's prior range of $54-59 billion. Additionally, the effective tax rate for the full-year of 2020 is expected to lie in the high-teens with possible fluctuations.

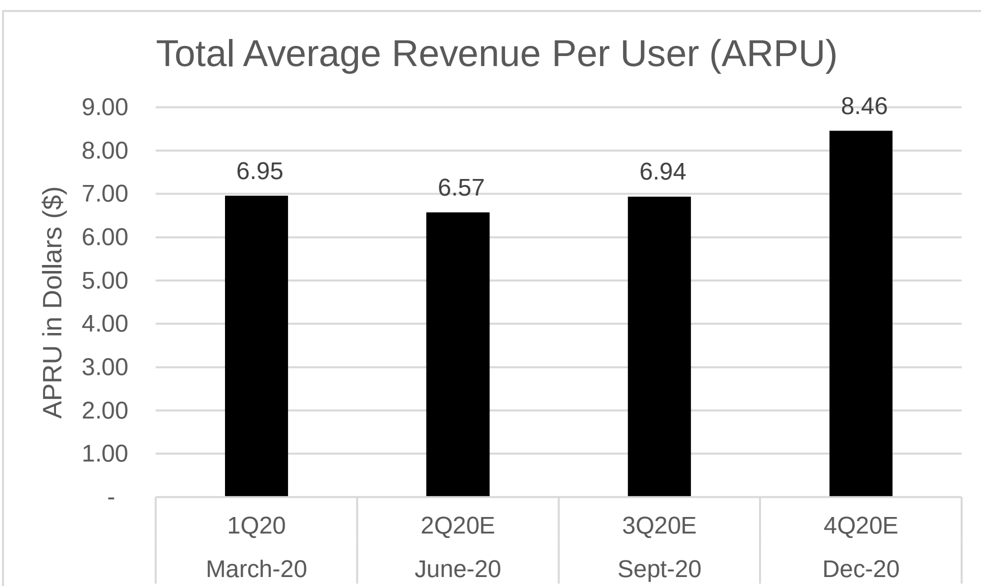
<u>Possible Catalysts</u>:

- **COVID-19**: The effects of the COVID-19 virus will continue to challenge companies across the globe, including Facebook. The two main areas of concern for Facebook include the number of MAUs and average revenue per user (ARPU).

- **Monthly Active Users (MAUs)**: Enclosed in the forecast provided, the number of MAU across the globe is forecasted to increase above average for the remainder of the FY 2020. The reason behind these forecasts stems from the global quarantine efforts of governments to prevent the spread of the COVID-19 virus. I believe that many of these individuals stuck at home during this time will increase their Facebook usage to both pass the time and connect with friends and family. This increase in MAUs is projected to last until the end of FY 2020 and revert to normal during the beginning half of the FY 2021. Due to the proactive efforts of the Asia Pacific market in combating the outbreak of the virus, the projected spike in MAUs has been lessened and is projected to revert to normal much faster than other geographical locations.



- **Average Revenue Per User (ARPU)**: Furthermore, it is projected that the ARPU will decrease over the near future before reverting to normal near the end of FY 2021. Due to the global economic decline, many organizations have decided to limit or eliminate their spending towards advertising on the internet. Being that Facebook heavily relies on its advertisement revenue, it is to be expected that Facebook will suffer financially following this outcome. As displayed in the model, ARPU will experience a decline in growth for Q2 and Q3 of FY 2020. Following this hit, I forecast that Facebook will make a slow recovery from Q4 of FY 2020 and into FY 2021 until approaching its average again at the end of FY 2021. Again, I will note that the Asia Pacific market has experienced less of a decline due to their active efforts in combating the COVID-19 virus.



<u>Further Analysis</u>:

- **Research and Development Expense (R&D)**: As mentioned during the Q1 earnings report summary, Facebook has access to 60.29 billion in cash, cash equivalents, and marketable securities. I believe that Facebook will use this funding to invest in R&D to boost user activity and stimulate other company projects. I expect Facebook to continue to invest in both labor and technological hardware soon to answer the surplus in MAUs. As more people remain at home to halt the spread of the COVID-19 virus, Facebook's equipment used to provide its services may become overwhelmed. As a result, Facebook will work to hire new talent and invest in the development of new technology to continue to provide its services to its users across the globe.

  Another area that should be highlighted is Facebook's gaming branch, named Facebook Gaming. The game streaming space is currently occupied by notable names such as Twitch and YouTube. Facebook has made it evident that they are willing to invest in this industry through their recent partnership with Mixer, a Microsoft game streaming platform. By investing in the gaming market, Facebook will need to increase its R&D expense for investment in acquiring users and partners to use the platform.

- **Marketing Expense**: It is to be expected that Facebook will face a loss of revenue due to the decrease in organizations investing in marketing and advertisements. To combat this downturn, I would expect Facebook to increase its marketing investment to regain some of its lost customers. This would either take the form of lowering prices for a certain period or offering promotions to new users. Either way, the loss Facebook is expected to see could be partially mitigated through reinvestment in marketing and potential outreach to current and potential advertisement partners.

- **Share Repurchase**: Another area of consideration lies in the actions of Facebook and through their efforts to repurchase company shares. Due to the economic downturn caused by the COVID-19 virus, Facebook's share price dipped to a low of $137.10. Because of this drastic dip, I forecasted that Facebook would increase its spending for share repurchases to $1.50 billion during Q2 FY 2020 with an estimated cost of $190.00 per share. I chose to use $190.00 because shares would continue to vary in price over the foreseeable future. I felt that $190.00 represented a fair average for share repurchases.

- **Outlook**: Overall, the outlook for Facebook in the short-term does seem slightly grim. It faces an increase in users; however, these users are becoming less profitable as advertisers continue to leave the platform. These events simultaneously lead to Facebook, having to invest more money to regain lost investments and prepare for the surplus in demand. I do feel that Facebook will recover and prosper in the future, but in the short term, I expect below-average performance in upcoming earnings reports.